Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
GTE CORPORATION,	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-184
	)	
BELL ATLANTIC CORPORATION,	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer Control.	)	
	)	

RESPONSE OF BELL ATLANTIC AND GTE IN SUPPORT OF THEIR FURTHER SUBMISSIONS

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I. INTRODUCTION AND SUMMARY

The further submissions by Bell Atlantic and GTE that are the subject of the public notice provide further confirmation that their merger is strongly in the public interest and should be approved. They do so, first, by enlarging the already extensive package of conditions filed previously by Bell Atlantic and GTE in order to produce still greater public interest benefits. And they do so, second, by modifying the proposal to transfer ownership and control of GTE Internetworking (now known as Genuity) to third party shareholders in order to provide added assurance that the proposal complies fully with section 271 and increases still further the merged company's already substantial incentive to obtain 271 relief as quickly as possible.

The few opponents who claim otherwise largely rehash arguments that have been refuted in prior comment rounds, or repeat claims that were rejected by the Commission in other proceedings. To the extent opponents raise new arguments at all, their claims only highlight the fact that their objections are not based on principles of law or sound public policy, but are simply brazen efforts to further their own private pecuniary interests by imposing added costs or burdens on a competitor. Their claims should be rejected, and the merger of Bell Atlantic and GTE should promptly be approved.

II0 THE EXPANDED CONDITIONS WILL FURTHER PROMOTE THE PUBLIC INTEREST

As the applicants previously demonstrated, the merger of Bell Atlantic and GTE will promote competition nationwide in a host of product and service markets including Internet, long distance, wireless, and local bundled services. And, while not necessary to find that the merger is in the public interest, the extensive package of proposed conditions filed by the applicants on January 27 would produce additional benefits. In fact, that proposal was patterned closely after the SBC/Ameritech conditions that the Commission itself concluded would promote competition for and the widespread deployment of advanced services, spur local competition generally, and help to ensure that consumers continue to receive high quality and low cost telecommunications services.

The additional conditions proposed by the applicants in their further submission would increase the public interest benefits still further, while also appropriately taking into account certain fundamental differences between the SBC/Ameritech merger and the present one. To the extent opponents argue otherwise, or claim that the proposed conditions should be expanded even further, their claims are unavailing. Each of the added conditions is addressed briefly below and in greater detail in Appendix A.

A. Carrier-to-carrier promotional discounts. In their further submission, Bell Atlantic and GTE propose to provide promotional discounts on residential unbundled loops and resale services, and to do so on terms that parallel those adopted by the Commission in the SBC/Ameritech proceeding. In that case, the Commission concluded that such discounts would produce affirmative public interest benefits. According to the Commission, the "carrier-to-carrier promotions for residential service will spur other entities to enter these markets and establish a presence in residential markets that can be sustained after expiration of the promotional discounts." *See SBC/Ameritech Order* _ 422.[1] If that was true in the case of SBC/Ameritech, and the Commission concluded it was, it also is true here.

[1] In the case of SBC/Ameritech, the Commission also concluded that the discounts helped to "offset the loss of probable competition between SBC and Ameritech for residential services." *See SBC/Ameritech Order* _

390. Here, in contrast, there is no such loss of probable, or even plausible, residential competition to offset. *See*, *e.g.*, Supplemental Filing of Bell Atlantic and GTE at 12-13 (Jan. 27, 2000) ("Bell Atlantic/GTE Supp. Filing"); Reply of Bell Atlantic and GTE in Support of their Supplemental Filing at 6-8 (Mar. 16, 2000) ("Bell Atlantic/GTE Supp. Reply").

The principal response from competing carriers is to attack the Commission's conclusion, arguing that the promotional discounts either are “insignificant” (MCI WorldCom at 7), or are “unlawful” because they are somehow discriminatory (AT&T at 3, 4-7).[2] The short answer is that,

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[2] Despite its contrary claims here, AT&T has long provided promotional discounts with limited availability, and has successfully (and correctly) maintained that those promotional discounts are non-discriminatory under the Act. *See, e.g., AT&T EasyReach 700 Service and AT&T 500 Personal Number Service*, 2000 FCC LEXIS 1861 (2000) (approving AT&T proposal to make 800 service available only to a small group of former customers of other AT&T services). In addition, the Commission has long recognized the lawfulness of promotional discounts or other arrangements with narrowly defined availability. *See, e.g., Personal Communications Industry Association’s Broadband Personal Communications Services*, 13 FCC Rcd 16857, _ 29 (1998) (“By now, there is a substantial body of precedent that promotional programs, volume discounts and other arrangements may be reasonable and non-discriminatory”); *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd 9564, _ 27 (1996) (temporary promotions are lawful “provided they are available to all similarly situated customers”); *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880, _ 129 (1991) (even individually negotiated contracts are not discriminatory if the same terms “are made generally available to other similarly situated customers willing and able to meet the contract’s terms”).

if competing carriers don't want the proposed discounts, the applicants would be glad to withdraw them. They are not necessary here in any event. If they do want them, however, the Commission itself has previously concluded that the promotional discounts do provide a significant benefit, s*ee SBC/Ameritech Order* _ 422, and expressly found that the discounts are non-discriminatory because they are being made available to all similarly situated carriers on the same terms, *id*. __ 495, 497.[3] Nothing more is required.

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[3] A few parties also claim that promotional loop discounts also should be provided to advanced service (as well as voice) providers. *See* MCI WorldCom at 8; Covad at 8. This makes no sense. The reason for the discounts is to spur entry into a market segment (residential voice) that competitors typically have not entered on a widespread basis – not just to provide a financial windfall to a few companies. *See SBC/Ameritech Order* _ 440.

In contrast, numerous competitors already provide advanced services, and it is cable companies rather than LECs that are the dominant incumbents. Moreover, so long as the promotional discounts are available to all similarly situated voice providers, there is no colorable claim that it is somehow discriminatory to not also provide discounts to differently situated advanced service providers. *See supra* n. 2 (and cases cited therein). This is especially true given that section 201 (b) – which the Supreme court concluded gives the Commission authority to implement the 1996 Act – expressly authorizes the Commission to establish different classes of communication that are subject to different charges. *See* 47 U.S.C. § 201(b); *see also Iowa Utils. Bd*., 525 U.S. 366 (1999).

B. Expanded most favored nation treatment. In their further submission, Bell Atlantic and GTE also propose to go beyond even the expanded most favored nation condition adopted in the SBC/Ameritech condition. Specifically, in addition to allowing competing carriers to adopt voluntarily negotiated agreements from other states, the proposed condition would allow them to immediately submit issues decided by arbitration in one state to arbitration in a second state – without waiting for the minimum statutory negotiation period of 135 days to expire. *See* 47 U.S.C. _ 252(b)(1). This will do two things. First, it will accelerate the ability of competing carriers to resolve issues in additional states. Second, precisely because of that, it will increase the merged company's existing incentives to resolve issues through negotiations in order to avoid the risk of receiving a potentially worse arbitrated result and having it quickly spread to other states through the accelerated arbitration mechanism.

In response, a few parties mechanistically repeat their earlier claims that competing carriers should be able to automatically adopt arbitrated terms from other states. *See* MCI WorldCom at 6; Allegiance at 2-4. As the Commission has found, however, doing so would be contrary to the Act because it would "interfere with the state arbitration process under sections 251 and 252" and allow one state effectively to preempt all other states. *See SBC/Ameritech Order* _ 491. Moreover, as we previously explained, expanding the condition as these parties propose would only compound the supposed problem (even presuming one exists) that they say they are trying to solve – a simple fact for which they have no answer to at all. *See* Bell Atlantic/GTE Supp. Reply at 16. Consequently, requests to expand the most favored nation provision even further should be rejected.

C. Promoting deployment of advanced services**.** In their original proposal, Bell Atlantic and GTE committed to provide advanced services through a separate affiliate on terms that parallel those adopted by the Commission in the SBC/Ameritech proceeding. The Commission previously concluded that this condition would promote competition for and the deployment of advanced services by "provid[ing] a structural mechanism to ensure that competing providers of advanced services receive effective, nondiscriminatory access to the facilities and services of the merged firm's incumbent LECs that are necessary to provide advanced services." *SBC/Ameritech Order* at _ 363.

In their further submission, Bell Atlantic and GTE modified the separate affiliate condition in order to provide additional benefits and to promote still further the deployment of advanced services. The modified condition would do so by expressly preserving the merged company's ability under certain conditions to provide wholesale advanced service arrangements to all carriers – including the merged company's separate affiliate and competing carriers alike – on non-discriminatory rates, terms and conditions.[4] This new wholesale option is in addition to (rather than in lieu of) any other options that are available to competing carriers under the Commission's rules,

[4] Specifically, the proposed condition would preserve the option of deploying advanced services equipment at remote terminals (and related central office equipment such as ATM edge devices needed to direct the traffic to the appropriate carrier) through the incumbent LECs. The ability to do so, however, is conditioned on using any such equipment solely to provide wholesale arrangements, on deploying equipment that is consistent with national standards where they exist, and on making those wholesale arrangements available to all carriers on the same terms.

creating yet another alternative vehicle that competitors can use to provide advanced services to consumers.

Preserving this option will strongly promote the deployment of advanced services by allowing equipment to be deployed economically to serve multiple carriers. This is especially true where, as with residential customers and less densely populated areas, some individual retail providers otherwise may not be willing to make the necessary investments to deploy the equipment themselves. And, at the same time, adding this option fully preserves the benefits perceived by the Commission in the creation of a separate data affiliate.[5]

Indeed, even a habitual opponent such as MCI WorldCom "strongly supports" making such wholesale arrangements available (at 3), and only a single party objects to the concept of permitting such wholesale arrangements, s*ee* Northpoint at 2. The sole basis for the objection, however, is that it might "prejudge" the outcome of a different proceeding that is now underway to determine whether such an arrangement is consistent with the terms of the conditions agreed to by SBC/Ameritech. But whether or not such an arrangement is consistent with the terms of that condition (or whether the Commission is willing to modify the condition if it is not) has no bearing here. The terms on which Bell Atlantic and GTE are willing to agree to a separate data affiliate expressly permit such an arrangement. As explained above, moreover, adopting the condition as proposed is both pro-

[5] As noted above, the Commission concluded that the "separate affiliate will provide a structural mechanism to ensure that competing providers of advanced services receive effective, non-discriminatory access to the facilities and services of the merged firm's incumbent LECs that are necessary to provide advanced services." *See SBC/Ameritech Order* _ 363. That continues to be true. The separate affiliate will ensure that competing providers obtain non-discriminatory access to any wholesale items offered by the incumbent LECs – including any arrangements offered under the terms of this condition.

competitive and will promote the deployment of advanced services. That should be the end of the matter.

The only other claim lodged by opponents here has nothing to do with the modifications proposed by the applicants in their further submission. Rather, it is merely a rehash of their previously-rejected argument that the separate data affiliate should be treated as a "successor or assign" of the incumbent LECs. *See* AT&T at 8; MCI WorldCom at 3. The Commission, however, exhaustively considered the same claim in the SBC/Ameritech proceeding, and rejected the contention that the separate data affiliate necessarily qualifies as a successor or assign of the incumbent LEC. *See SBC/Ameritech Order* _ 444-76. Quite the contrary, the Commission adopted an express presumption that, as long as the parties adhere to the terms of the condition, it does not. *Id.* _ 445.

D. <u>Uniform interfaces for access to OSS</u>. Bell Atlantic's and GTE's further submission also provides for still greater uniformity in the interfaces and business rules that are used by competing carriers to obtain access to operations support systems. In addition to providing complete uniformity within each of the respective companies' territories, the applicants' propose to provide greater uniformity between those territories where they can do so without incurring prohibitively large costs and without disrupting the operation of carriers who already are using those interfaces.

First, Bell Atlantic and GTE propose to provide uniform interfaces and business rules throughout their combined mid-Atlantic operating territories extending from Maine to Virginia – including in the two states where both companies operate as incumbent LECs (Pennsylvania and Virginia). This modification, which was first proposed by a group of competing carriers (*see* Allegiance March 1 Comments at 8), will allow competitors in those states to interconnect using a single set of interfaces and business rules, rather than the two different sets the respective companies have in those states today.

Second, the modified condition now provides for greater uniformity of interfaces nationwide as well, and would require the merged company to employ common transport and security protocols throughout its combined service areas. This will provide added benefits for the small number of competitors (about 11 percent) who operate in both companies' service territories. And it will do so without requiring the sort of massive system changes that would impose enormous costs and disrupt the operations of the majority of carriers who operate only in one or the other of the two companies' service areas.

The expected response from a few opponents is that this isn't enough of a burden, and the merged company (and other competing carriers) should have to incur the enormous cost – upwards of a billion dollars (*see* Lacouture Decl. _ 10) – to provide complete uniformity nationwide. Ironically, the key proponents of this approach (AT&T at 19-20 and MCI WorldCom at 10) have taken the opposite position elsewhere. For example, they warned the California commission that requiring broad uniformity would "undo much of the effort that AT&T and MCI WorldCom have already expended trying to get operational OSS from each applicant," and would "ultimately hinder the efforts of AT&T, MCI WorldCom, Sprint and other CLECs to compete against GTE in California."[6] Moreover, AT&T recently explained to this Commission that it has chosen not to use the same interfaces for all of its local operations, even where they are available. *See* Appendix A at A-10-11. And even here, while AT&T (at 19-20) pays perfunctory lip service to its claim that the

[6] *See* AT&T/MCI Brief filed in *In re Joint Application of GTE Corp. and Bell Atlantic to Transfer Control of GTE's California Utility Subsidiaries*, Case No. A 98-12-0005at 36 (Calif. PUC); *see also* Bell Atlantic/GTE

merged company should provide uniformity nationwide, it also says it doesn't want uniformity if it would detract from other systems work that is underway – which it most assuredly would.

Moreover, these sometimes converts to the cause of broad uniformity (or, at least, of imposing larger burdens on competitors) don't even try to rebut the prior showings by Bell Atlantic and GTE that moving to complete uniformity nationwide would impose enormous cost and disruption on all concerned with little benefit. Instead, they say only that if it's possible to provide uniformity in Pennsylvania and Virginia, then it should not require much more to do so nationwide. This simply ignores the explanation of how uniformity in those two states would be accomplished. Because of the uniquely large differences in the two companies' underlying networks and operations systems – and the resulting complexity, technical difficulty and cost of developing uniform interfaces and business rules to work with both – the merged company likely will achieve uniformity in large part by changing the underlying network. *See* Lacouture Decl. _ 12. It is possible to do so in Virginia and Pennsylvania where both companies operate because there ultimately may be some operating efficiency gains to help offset the large costs. But if AT&T and MCI WorldCom are now suggesting that the merged company should spend the multiple billions of dollars that it would cost to change out switches and operating systems nationwide, that claim is so breathtakingly extreme it answers itself.

E. Uncontested proposals. In their further submission, Bell Atlantic and GTE also propose to add to or modify the conditions in several respects that the Commission previously found would serve the public interest. For example, the applicants modified the out of region investment

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Supp. Reply at 13, n.5 (listing additional citations and quotes).

condition to establish annual benchmarks, ensuring that all the out of region investment cannot be postponed until the end of the three-year term of the conditions. *See SBC/Ameritech Order* _421, 439. They agreed to continue to provide line sharing and the other network elements required by the Commission's *UNE Remand Order* during the pendency of any appeals of those orders, and to fund third party audits of the merged company's compliance with those requirements. *Id.* __ 386-87, 422, 435. And they agreed not to impose mandatory minimum charges on interLATA services throughout the merged company's domestic service territory, regardless of when market leader AT&T finally gets around to fulfilling its commitment to do the same. *Id.* _ 400. No party offers any substantive objection to these conditions. They should be adopted as proposed.

III. THE PROPOSED SPIN-OFF OF GENUITY IS FULLY CONSISTENT WITH THE TERMS AND PURPOSES OF SECTIONS 3(1) AND 271.

On April 28, Bell Atlantic and GTE proposed significant revisions to our proposal to spin off Genuity in order to provide still further assurances that the proposal complies fully with both the letter and spirit of the Act.[7] In particular, that further submission made significant revisions to the terms of NewCo's conversion rights, the selection of Genuity's independent board, and the contours of NewCo's investor safeguards.[8]

Under the terms of our modified proposal, the public will own at least 90 percent of the shares of Genuity and NewCo will own less than 10 percent of those shares. NewCo's option to acquire more than 10 percent of Genuity's shares arises only if NewCo eliminates applicable 271 restrictions as to more than 50 percent of Bell Atlantic's lines. If NewCo fails to reach this threshold

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[7] We previously presented a comprehensive legal justification of our spin off proposal, as originally structured, in an April 3 *ex parte* filing. That showing remains fully applicable and largely unanswered. *See*, Letter from William P. Barr to Magalie Roman Salas (Apr. 3, 2000).

[8] Letter from William P. Barr to Magalie Roman Salas (Apr. 28, 2000).

within five years, the 90 percent public ownership structure will be permanent. Even if NewCo passes the threshold, NewCo cannot exercise the option and own more than 10 percent of Genuity until it has eliminated all applicable 271 restrictions. Furthermore, if NewCo sells its option before eliminating those restrictions as to 95 percent of Bell Atlantic's lines, NewCo will realize none of Genuity's unique appreciation beyond a 10 percent equity interest, and will only receive a standard (S&P 500) return on the remainder of its original investment in Genuity.

This modified proposal only further confirms that NewCo will not "own or control" Genuity pending 271 relief. Under the Act, to "own" means "to own an equity interest (or the equivalent thereof) of more than 10 percent"; the concept of control is not further defined. 47 U.S.C. § 151(1). The precise issues here are whether (i) NewCo's conversion rights constitute an "equity interest (or the equivalent thereof) of more than 10 percent" and thus "ownership" of Genuity, and (ii) whether, by virtue of the various terms of our proposal, NewCo will "control" Genuity.

The answer to both these questions is an emphatic "no," as the overwhelming weight of *relevant* legal authority – including judicial, Commission and MFJ precedent – makes abundantly clear. Nonetheless, in a last gasp attempt to block a merger that will produce a stronger competitor to it, AT&T claims otherwise. In order to do so, however, it is forced to retreat to an absolutist position that *all* options constitute a current equity ownership interest. And it is forced to rely on authorities from a host of unrelated areas – including the securities laws, the bankruptcy code and even financial accounting practices – that have no bearing here (and in many instances actually contradict its own arguments). Ironically, AT&T points to virtually everything under the sun except the purposes of section 271 itself.

In the end, the very most that AT&T can hope to accomplish is to show that the statutory terms are ambiguous and susceptible of more than one interpretation. But even assuming our reading of the statute is not compelled by its plain terms, that merely means that the agency charged with administering the statute must inevitably make "policy choices" when filling in the gaps left by these ambiguities, and has latitude to adopt any permissible construction of the statute that in its view reconciles "competing views of the public interest." *See Chevron U.S.A. Inc v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 865-66 (1984). And a reviewing court "must defer to [that] interpretation so long as it is *reasonable, consistent with the statutory purpose, and not in conflict with the statute's plain language*." *Public Citizen v. Carlin*, 184 F.3d 900, 903 (D.C. Cir. 1999), *cert. denied*, 120 S. Ct. 1267 (Mar. 6, 2000) (emphasis added) (citation omitted).

It follows that AT&T has erroneously framed the inquiry in this case by insisting that the issues here are "not of policy," Opposition at 29, and that section 3(1) forbids the Commission's "weighing of competing policy considerations." AT&T's March 10 Ex Parte at 1. Even under the most charitable reading of AT&T's arguments, the Commission is well within its authority in relying on its own "views of wise policy to inform its judgments" of how best to resolve ambiguities in the statute. *Chevron*, 467 U.S. at 865. The issue, therefore, is not whether the Commission may legally approve our proposal – as we demonstrate below it unquestionably can – but simply whether it should. As we explain further below, it plainly can.

We respond below, as appropriate, to each of the arguments made in AT&T's May 5 Opposition.[9] In support, we attach a Third Supplemental Declaration of Professor Ronald J. Gilson

[9] At the outset, we must respond to two of AT&T's accusations. First, AT&T falsely charges that we have mischaracterized GTE's April 10 statements to investment analysts. *See* Opposition at 8. But it was made clear

("Gilson Third Supp. Decl.") (Appendix B), and a Declaration of Paul R. Gudonis (Appendix C). We also attach, as a combined Appendix D, a Revised Exhibit A, which clarifies (without substantive change) our modified proposal, as well as a Revised Exhibit C, which further relaxes one of NewCo's investor safeguards.

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in those statements that GTE, even in the absence of the merger, would still likely conduct a partial IPO of Genuity's stock, and thus GTE was accurately describing its likely accounting treatment for Genuity on a "standalone" basis. Second, AT&T implies that GTE's petition for section 32.72(c) waiver of its transitional commercial transactions with Genuity somehow proves that we "do not believe" that Genuity will not be an affiliate of NewCo. Opposition at 7 & n.4. But as GTE's section 32.72(c) waiver petition stated, the reason GTE sought the waiver was precisely because "[a]fter GTE's ownership in Genuity is reduced to 10 percent, Genuity will become a non-affiliate under the Act . . ." Petition of GTE Service Corporation and GTE Consolidated Services Incorporated for Waiver of 47 C.F.R § 32.72(c) (Apr. 25, 2000), at 3. GTE simply asked that its transitional services be exempted from the FDC or FMV recording requirements of section 32.27(c) in order to "support the transition of a limited set of functions to Genuity" and thereby "facilitate the smooth transition to Genuity's operation as an independent company." *Id*.

A. NewCo's Option Is Not Ownership Of An Equity Interest Or The Equivalent Thereof.

Section 3(1)'s ownership standard is not met unless NewCo would "own an equity interest (or the equivalent thereof) of more than 10 percent." Given the use of the present tense ("owns," "is owned," "is under common ownership"), that standard would be met only if NewCo's option to acquire stock in Genuity were itself, currently and before any future exercise, "an equity interest" or "the equivalent thereof."[10] But the Commission can and should conclude that the option here, a conversion right subject to specified conditions, is neither an equity interest nor the equivalent of such an interest.

[10] *See, e.g.*, *Sutton v. United Air Lines*, 119 S. Ct. 2139, 2146 (1999) (holding that because a statute defined "disability" in the "present indicative verb form" as an "impairment that substantially limits" a major life activity, the statute "requir[es]" that a person "be presently – not potentially or hypothetically – substantially limited in order to demonstrate a disability"); *United States v. Wilson*, 503 U.S. 329, 333 (1992) ("Congress' use of a verb tense is significant in construing statutes.").

1. NewCo Will Not "Own" a Prohibited "Equity Interest" in Genuity.

The best construction of "equity interest" – and certainly a permissible construction – excludes the option NewCo would hold in Genuity. The three legal rights that traditionally accompany equity ownership are the rights to vote, to participate in corporate earnings, and to participate in dissolution proceeds.[11] The NewCo conversion right, or option, is not a share of the corporation, but only the right to acquire a share of the corporation in the future. Until exercised, it confers none of the three participation rights of equity ownership: before exercising the right to acquire greater than 10 percent of Genuity, NewCo is not entitled to more than 10 percent of the vote, earnings or liquidation distributions of Genuity. The NewCo holding, therefore, lacks the set of critical attributes that are characteristic of an "equity interest."

[11] *See, e.g.*, First Gilson Decl. ¶ 16.

This understanding is confirmed not only by common legal usage, see *Association of Flight Attendants v. USAir Inc.*, 24 F.3d 1432, 1435 (D.C. Cir. 1994) ("USAir has *no present equity interest* in Shuttle, but it has *an option to purchase a controlling interest* in the company effective October 10, 1996.") (emphasis added), but also by the legal treatment of options and conversion rights in numerous contexts. For example, numerous corporate law precedents specifically conclude that an option to acquire stock, or a debenture convertible into stock, is not an "equity interest." *See, e.g., Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 5 (S.D.N.Y. 1997) ("Many cases hold that an option contract does not qualify as an equity interest.")*; Starkman v. Warner Communications, Inc.*, 671 F. Supp. 297, 304 (S.D.N.Y. 1987) ("The [option] instrument stands alone, claiming no equity in the corporation, entitled to no vote, and with no fiduciary obligation of the management to the optionholder's interest."); *Hecht v. Papermaster*, No. L-12691-96, slip op. at 108 (N.J. Super. Ct. May 12, 1998) ("plaintiffs do not and did not hold an equity interest"); *Simons v. Cogan*, 549 A.2d 300, 303-04 (Del. 1988) ("A debenture is a credit instrument which does not devolve upon its holder an equity interest in the issuing corporation . . . . Similarly, the convertibility feature of the debenture does not impart an equity element until conversion occurs."); *Kusner v. First Pennsylvania Corp.*, 395 F. Supp. 276, 281 (E.D. Pa. 1975), *rev'd on other grounds*, 531 F.2d 1234 (3rd Cir. 1976) (holding same); 18A Am. Jur. § 565 (1985) ("the holder of a convertible bond is generally considered to be, during the time the bonds are running, in no sense a stockholder, and is not considered to have any vested right in any particular stock").[12]

This general principle of law – that options and convertible rights are not "equity interests" or ownership until exercised – is also reflected in the legal contexts most relevant to the present proposal. First, the acquisition of an option, warrant or similar convertible interest does not trigger Hart-Scott-Rodino merger review under the antitrust laws. *See* 16 C.F.R. § 802.31 (exempting acquisition of "convertible voting securities" from HSR reporting requirements). Rather, only "subsequent conversions" of such interests trigger review. *Id.*

Second, the Commission has consistently ruled that options and other convertible interests are only "potential future equity interests" and not current ownership interests for purposes of various

[12] *See also Martin v. Schindley*, 442 S.E. 2d 239, 241 (Ga. 1994) ("An option to purchase land does not, before acceptance, vest in the holder of the option *any interest, legal or equitable,* in the land.") (emphasis added); *Ball v. Overton Square, Inc.*, 731 S.W.2d 536, 540 (Tenn. Ct. App. 1987) ("[A]n option to purchase stock does not vest in the prospective purchaser *an equitable title to, or any interest or right,* in the stock.") (emphasis added); James on Option Contracts § 501 (1916) ("the weight of authority" "holds that an option contract to purchase *does not vest any estate, legal or equitable*, in the optionee prior to his election to purchase") (emphasis added); 12A Fletcher Cyclopedia of Private Corp. § 5575 (1993) ("An option to purchase stock does not vest in the prospective purchaser *an equitable title to, or any interest or right in*, the stock.") (emphasis added).

ownership limits designed to safeguard competition. *Biennial Review of Spectrum Aggregation Limits*, Report and Order, WT Docket No. 98-205, ¶ 8 (Sep. 22, 1999). *See also In re Woods Communications Group*, 12 FCC Rcd 14042, ¶¶ 13-14 (1997) (characterizing options as "future equity holdings" and "possible equity interest[s]"). These include the Commission's CMRS spectrum cap rules, 47 CFR § 20.6(d)(5) (CMRS spectrum cap rules) (excluding options, warrants and other conversion rights from attribution); its LEC/LMDS cross-ownership rules, *id*. § 101.1003(e)(5) (LEC/LMDS cross-ownership rules) (same); its application of section 310's foreign ownership ban, *BBC License Subsidiary*, 10 FCC Rcd 10968, ¶ 20 n.12 (1995) (foreign ownership ban of 47 U.S.C. § 310(b)(4)) ("future interests, such as options and convertible rights, are not relevant to our alien ownership determinations until converted"); its cable attribution rules, 47 C.F.R. § 76.501, Note 2(e) (cable attribution rules) (same); and its former cable-telco cross-ownership rules, 47 C.F.R. § 63.54(e)(5); *In re Telephone Company-Cable Television Cross-Ownership Rules,* 10 FCC Rcd 244 (1994).

The *Fox Television Cases*, stressed by AT&T, Opposition at 12-15, simply confirm that determinations of corporate ownership turn upon the presence or absence of the three corporate participation rights of voting, earnings and liquidation distributions. There, the foreign corporation News Corp. owned only 24 percent of Fox's voting stock, but the Commission nonetheless concluded that News Corp. held greater than section 310(b)(4)'s foreign ownership ceiling of 25 percent of the "capital stock" *because* it had "the right to substantially all of [Fox's] profits and losses and also [had] the right to substantially all of [Fox's] assets upon its sale or dissolution." 10 FCC Rcd 8452, ¶ 50. Indeed, although *Fox Television* did not address the precise question presented here – whether options and other conversion rights constitute current equity ownership – several other foreign ownership cases have squarely concluded that they do not. *See, e.g.*, *Nextwave Personal Communications, Inc.*, 12 FCC Rcd 2030, ¶ 46 (1997) ("future interests including warrants, options, and convertible debt do not constitute capital stock until exercised or converted"); *see also* GTE March 14, 2000 Ex Parte at 13 n.6 (citing authorities).

Third, the general rule that potential future interests are not current equity ownership is reflected in the precedents under the MFJ, which was the immediate precursor to section 271. In a long line of cases, the Justice Department approved and Judge Greene allowed options and other conditional interests to be acquired by Bell companies in prohibited businesses, including interLATA businesses. *See, e.g.*, Supp. Filing at 40-43. In the proceeding in which Judge Greene approved the first such option, thereby allowing NYNEX to purchase a fixed-price option in a company constructing interLATA circuits between the U.S. and Europe, the Justice Department wrote:

> During the interim period [while NYNEX held the option], NYNEX would not have any kind of equity interest in Tel-Optik.

Report of the United States to the Court Concerning Proposed Purchase by NYNEX Corp. of Conditional Interest in Tel-Optik, Ltd., at 10, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed June 20, 1986). *See also id.* at 12 ("The conditional interest to be secured by NYNEX does not constitute an 'equity interest' as that term is normally used."); Response of the United States to Comments Concerning the Proposed Purchase by NYNEX Corp. of a Conditional Interest in Tel-Optik, Ltd., at 12, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed July 11, 1986) ("NYNEX Will Not Acquire an Equity Interest in Tel-Optik As a Result of the First Step of the Proposed Transaction"). Judge Greene used the term "equity interest" similarly in the same case, and contrasted a Bell company's acquisition of the initial option which "shall not" require "the approval of the Court," with the "actual acquisition by a Regional Holding Company of an equity interest in an entity engaged in activities prohibited by the decree [which] may not occur without a waiver granted by the Court." Memorandum at 6, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. Aug. 7, 1986). These precedents by themselves conclusively disprove AT&T's premise that potential future interests are necessarily, or even ordinarily – or, critically, likely believed by the 1996 Congress to be – "equity interests."

The MFJ precedents are especially important to this inquiry because section 3(1)'s definition of "affiliate" appears to have been patterned on the definition of "affiliate" in section IV(A) of the MFJ. Section 3(1) reads:

> The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For purposes of this paragraph, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent.

47 U.S.C. § 151(1). This language exactly parallels the MFJ's definition of "affiliate":

> "Affiliate" means any organization or entity . . . that is under direct or indirect common ownership with or control by AT&T or is owned or controlled by another affiliate. For the purposes of this paragraph, the terms "ownership" and "owned" mean a direct or indirect equity interest (or the equivalent thereof) of more than fifty (50) percent of an entity.

MFJ Section IV(A). Both definitions begin with a broad defining sentence including the elements of "direct or indirect," "ownership," "control" and "common ownership." The second sentences of the two definitions are virtually identical to each other – including their use of the identical phrase "equity interest (or the equivalent thereof)" – although the percentage of equity interest that triggers affiliation differs. When Congress codifies a specific phrase such as "equity interest (or the equivalent thereof)" in the same context where it was previously employed, Congress must have intended to incorporate the prior accepted meaning of that phrase.

The preceding authorities readily establish the familiarity of excluding mere options from current equity interests. Rather than come to grips with these authorities, AT&T has once again muddied the waters by relying on authorities from unrelated areas – primarily securities, bankruptcy and accounting – as if definitions (of varying terms) from such areas control the available meaning here. Other commentators who also oppose Bell Atlantic/GTE's proposal nonetheless properly reject that suggestion: "the Commission should look beyond the question of whether a particular arrangement would create an equity interest for accounting, tax, or securities law purposes" and instead "develop a standard" based on the "policy objectives" of section 271. Information Technology Association of America, Opposition at 4; *see also* Association for Local Telecommunications Services, Opposition at 9. The Commission has recognized that such wholesale importation would be an abdication of its role to construe a statute consistent with the particular statutory context. *See In the Matter of AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd 21438, ¶ 27 n.108 (1998). AT&T's authorities cannot properly be transposed to control the Commission's decision here.

Securities Laws. That the securities laws regard an option as an "equity *security*" for the purposes of insider trading prohibitions does not establish that NewCo's option must be regarded as an "equity *interest*" by the Commission. AT&T has simply pointed to a different term in a different statute that serves a very different purpose. *See generally* Gilson Supp. Decl. ¶¶ 4-16 (discussing at length the "entirely different" purposes of the securities laws); Gilson Second Supp. Decl. ¶ 8. Indeed, before 1991 options were *not* uniformly regarded as "equity securities" even for purposes of the securities rule relied upon by AT&T.[13] The Securities and Exchange Commission expressly altered the rule – and acknowledged the change in position – in 1991 so that the rule would apply to options.[14] This history confirms our *Chevron* argument that the ambiguous terms "own" and

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[13] Before 1991 "there was considerable controversy concerning whether options should qualify as 'equity securities of [the] issuer' within the meaning of § 16(b)." *Citadel Holding Corp. v. Roven*, 26 F.3d 960, 964-65 (9th Cir. 1994). A number of courts had held that options were not equity securities, *see id.* (discussing cases); *Petteys v. Butler* 367 F.2d 528, 537-38 (8th Cir. 1967) (same).

[14] In 1991 the SEC rewrote its rules interpreting section 16 to make, for the *first time* since the creation of section 16(b), "the acquisition of a derivative security . . . a reportable event." *Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, 56 F.R. 7242, 7250 (Feb. 8, 1991). The SEC acknowledged that this was a drastic change in law that "not only *reverses* the Commission's own regulatory approach but also differs from a line of cases that, in the absence of rules to the contrary, have held that an acquisition of a right is not a purchase of an equity security unless accompanied by an irrevocable liability to pay for the stock, or other indicia of beneficial ownership." *Id*. The SEC's decision to re-define equity security to include derivative

"equity interest" – like the different term "equity securities" – must be interpreted in light of the particular policy purposes of the statute in which they appear.

securities for the purpose of section 16(b) was an exercise of that Commission's discretion based on its conclusion that such a modification would promote the disclosure purposes of section 16(b). *Id.* at 7248-49.

Bankruptcy Law. AT&T draws on yet another statute – the bankruptcy code – to establish that options are always "equity securities." That the bankruptcy code specifically defines options as "equity securities" further confirms that the term "equity" does not unambiguously include options. Otherwise, this specification in the bankruptcy code would be superfluous. And just like the securities laws, the bankruptcy code defines a different term and serves very different purposes than the Communications Act. One of the primary purposes of bankruptcy law is to prioritize claims against an estate in bankruptcy. To further this policy, bankruptcy law treats *some* potential future interests – such as options – like equity for the purpose of prioritizing the holder's economic interest in the estate. But it also treats *other* such interests – such as convertible debt – as debt rather than equity in order to protect the priority status of that interest. *See, e.g.*, Opposition at 18 n. 16 (discussing section 101(16)(C) of the bankruptcy code). The point is that bankruptcy courts craft their interpretations of the bankruptcy code in light of the unique aims of bankruptcy law,[15] and AT&T has not explained why those interpretations are relevant here.

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[15] *See, e.g.*, *Allen v. Levey*, 226 B.R. 857, 862 (Bankr. N.D. Ill. 1998) (holding that equity security interest should be defined broadly when determining bankruptcy estate due to purpose of Act) (cited by AT&T); *In re*

Eastern Maine Elec. Coop., Inc., 121 B.R. 917, 929 (Bankr. D. Maine 1990) (holding that because bankruptcy code is unique, the definitions it contains must be read in light of the particular "statutory and factual terrain" of bankruptcy).

Interestingly, for all of AT&T's talk about "uniform" treatment of options across the securities and bankruptcy contexts, Opposition at 19, bankruptcy courts have specifically concluded that there is no necessary overlap between the definition of the term "equity security" in the securities laws and the bankruptcy code. *See In re Eastern Maine Elec. Coop., Inc.*, 121 B.R. at 930 ("Thus, notwithstanding the broad definition of 'security' under the securities acts, the limits of the term as heretofore defined may well be inadequate to the task set by the Bankruptcy Code."); *see also id.* at 929-932 (holding that definition of "equity security" in securities law was not the same as definition in bankruptcy law). And AT&T concedes that the bankruptcy code does not treat convertible debt as equity, even though the securities laws do, see Coffee Decl. ¶ 15, because of the bankruptcy-specific policy of not wanting "the debt holder to lose the priority status to which it is entitled." Opposition at 18 n.16 (citing authorities).

If anything, bankruptcy precedent strongly suggests that an option similar to NewCo's would be regarded as neither an "equity interest" nor conferring "ownership." A warrant issued by a debtor in bankruptcy is *not* an "equity security" for bankruptcy purposes where the warrant is invalid before court approval because such a warrant "until approved . . . constitutes no more than a *prospective* warrant which is insufficient to satisfy the definitional requirements for an 'equity security.'" *In re Daig Corp.*, 48 B.R. 121, 132 (Bankr. D. Minn. 1985) (emphasis added). Moreover, under bankruptcy law, even a share of common stock is deemed to lack "all the indicia of ownership" and its holder considered not to be an "owne[r]" of "equity" where the stock is stripped of voting rights and the instrument is not freely transferable. *In re Motels of America, Inc.*, 146 B.R. 542, 544 (Bankr. D. Del. 1992). Under these cases, NewCo's conversion rights would not be an equity security because those rights allow NewCo to acquire more than a 10 percent interest in Genuity only after the elimination of all applicable 271 restrictions and is transferrable only after NewCo meets the 50 percent 271 threshold.

Financial Accounting. AT&T's reliance on accounting principles for the proposition that an option is an equity interest, *see* AT&T May 5 Opposition at 9, 18 n.17, is wholly misplaced. Although AT&T is correct that the Financial Accounting Standards Board ("FASB") in *some* instances treats options like common stock, it omits the fact that this occasional treatment of options is motivated solely by the particular goals of accounting, which are irrelevant here. Indeed, in the very opinion relied on by AT&T, the FASB expressly provides that its decision occasionally to treat options as common stock is limited to the calculation of a *single* piece of data and is not a generally applicable rule *even for accounting purposes*. *See* FASB, Accounting Standard, Accounting Principles Board, Opinion No. 15, ¶ 39 (rel. 1969) ("The designation of securities as common stock equivalents in this section *is solely for the purpose of determining primary earnings per share*. No changes from present practices are recommended in the accounting for such securities.").[16] In addition, the FASB opinion cited by AT&T, by implication, proves that options are *not* equivalent to shares. By expressly providing that in some instances options should be "*regarded as*" common stock, the opinion implicitly recognizes that options generally are *not* equivalent to stock.

What is more, AT&T disregards the fact that the FASB opinion it cites has been superseded by a later FASB statement. And under the current rule, NewCo's option here would *not* be regarded as common stock or its equivalent. In Statement of Financial Accounting Standards No. 128 ("SFAS

[16] In the opinion AT&T cites, the FASB explains that options should be "*regarded as* common stock" for the purpose of calculating a company's earnings per share (which is determined by dividing a company's net income by the number of outstanding shares) to avoid over-inflation of the data caused by failing to take into account the options that might be converted into shares in the future (and thereby increase the denominator in the aforementioned equation). *Id*. ¶¶ 1-3, 15. Accordingly, the cited FASB opinion instructs companies to include in their financial statements an estimate of earnings per share that "regards options as common stock" – this is referred to as a "fully diluted" earnings per share estimate. Potential investors reviewing the financial statement of a company can therefore know the upper and lower limits of the company's earnings per share. *See id*. ¶ 40.

No. 128”), the FASB amended the opinion AT&T cites to provide that, when a right to convert an option into stock is contingent upon some future event, the option is *not* regarded as common stock until that event occurs. *See* SAFS No. 128 ¶¶ 30, 34, 35 (Feb. 1997). Under this rule, NewCo’s option would not be regarded as common stock in DataCo, even for the limited accounting purpose of calculating fully diluted earnings per share, *unless and until* NewCo first satisfies contingencies that are a prerequisite to the exercise of the option. *See id.* Furthermore, under current generally accepted accounting purposes, *even after* NewCo crosses the 50% section 271 threshold, but before conversion, the conversion right is treated only as a “potential common share outstanding” in the calculation of diluted earnings per share. Id. at ¶ 35. Accordingly, current accounting practices further confirm that the option here is not an equity interest.

Derivative Suits. While AT&T is correct that some “federal courts have also held that option holders may bring derivative suits” like shareholders, Opposition at 18, AT&T fails to mention that the holdings it relies on constitute the decisive minority rule. Indeed, the two cases AT&T cites for this point appear to be the *only* two such cases. On the other side of the ledger, however, are numerous cases holding that only ownership of shares confers standing to pursue a derivative suit:

> The timber of sound reason forms the conceptual underpinning of the rule requiring stock ownership in a corporation as the prerequisite for bringing a derivative action in its behalf. Only by virtue of the shareholder’s interest, which has been described as a proprietary interest in the corporate enterprise which is subject to injury through breaches of trust or duty on the part of the directors, does equity permit him to step into the corporation shoes and seek in its right the restitution he could not demand on his own. Standing is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal plaintiff may acquire qua stockholder of the corporation which is the real party in interest. Without this relationship, there can be no standing, no right in himself to prosecute this suit.

Kauffman v. Dreyfus Fund, Inc., 434 F.2d 727, 735 (3d Cir. 1970) (citations omitted). The same rule applies to the holders of convertible securities.[17] Consistent with these rules, an overwhelming majority of courts have held that the holder of a convertible security is owed no fiduciary duty by the directors and officers of the corporation.[18] Once again, these cases demonstrate that corporate law draws a fundamental distinction between equity owners on the one hand and option or convertible security holders on the other.

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[17] *See Kusner v. First Pennsylvania Corp.*, 395 F. Supp. 276, 282 (E.D. Pa. 1975), *rev'd on other grounds*, 531 F.2d 1234 (3rd Cir. 1976) ("the concept of proprietary interest is distorted beyond analytical usefulness when the holder of a mere option to purchase shares who has not yet exercised his option or legally committed himself to the exercise of his option is held a shareholder under Rule 23.1."); *Harff v. Kerkorian*, 324 A.2d 215, 219 (Del. Ch. 1974) ("the conclusion is inescapable that plaintiffs [holders of convertible debentures] are creditors of MGM and simply do not have standing to maintain a stockholder's derivative action."); *Kessler v. General Cable Corp.*, 92 Cal. App. 3d 531, 540 (Cal. Ct. App. 1979) ("The view remains, generally, that holders of debentures, with an option to convert, remain corporate creditors only, without any special status which affords them the opportunity to litigate in the area of potential damage to their economic interests.") (citing *Helvering v. Southwest Corp.*, 315 U.S. 194 (1942); *Levine v. Chesapeake & O.R. Co.*, 60 A.D.2d 246 (N.Y. 1977)); *Brooks v. Weiser*, 57 F.R.D. 491, 494 (S.D.N.Y. 1972) ("The fact that among the plethora of derivative suits brought over the generations none even discusses the issue (of whether or not creditors are entitled to sue on behalf of the debtor corporation) reflects the obviousness of the proposition that the right to sue derivatively is an attribute of ownership, justified on the theory that the plaintiff in such a suit seeks to recover what belongs to the corporation, because as a co-owner, it also belongs to him."); *Dorfman v. Chemical Bank*, 56 F.R.D. 363 (S.D.N.Y. 1972) (plaintiff was debenture holder; held insufficient interest to bring derivative suit).

[18] *Glinert v. Wickes Cos.*, No. 10407, 1990 WL 34703, *9 (Del. Ch. Mar. 27, 1990) ("Under our law, the option feature of these instruments does not qualify for the protections that flow from a fiduciary duty. Our prior cases have held that an option to buy stock in futuro does not make one an equitable stockholder."), *aff'd*, 586 A.2d 1201 (Del. 1990); *Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 6 (S.D.N.Y. 1997) ("Clearly, any attempt to analogize options to stocks in order to suggest a fiduciary duty are to no avail."); *Simons v. Cogan*, 549 A.2d 300, 303-04 (Del. 1988) ("a mere expectancy interest does not create a fiduciary relationship. Before a fiduciary duty arises, an existing property right or equitable interest supporting such a duty must exist. The obvious example is stock ownership. Until the debenture is converted into stock, the convertible debenture holder acquires no equitable interest and remains a creditor of the corporation whose interests are protected by the contractual terms of the indenture."); *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171 (Del. 1988) (holding same); *Starkman v. Warner Communications, Inc.*, 671 F. Supp. 297, 304 (S.D.N.Y. 1987) ("The [option] instrument stands alone, claiming no equity in the corporation, entitled to no vote, and with no fiduciary obligation of the management to the optionholder's interest."); 18A Am. Jur. § 565 (1985) ("corporate directors owe no duty to consider the interests of debenture holders in determining the price for converting debentures into stock.").

American Law Institute. AT&T's reliance on the American Law Institute's Principles of Corporate Governance ("ALI Principles") is equally misplaced. At the outset, AT&T blatantly mischaracterizes these principles as a "restatement" of the law. *See* Opposition at 19. Since the inception of the ALI, its members have debated whether to produce a restatement on the law of corporations and have repeatedly voted *against* issuing a restatement. *See* ALI Principles, President's Foreword. The current version of the ALI Principles is *not* a statement of current law and does not even purport to be a restatement of the law. Instead, it forms the "recommendations" and the "Institute's views" of what the law *should* be. *See id.*; Gilson Third Supp. Decl. ¶ 8 n. 1. Indeed, as the President of the ALI observes: "There will never be a time when the work is done and its results labelled 'A Complete Restatement of the Law.'" *See* ALI Principles, President's Foreword. In other words, the ALI Principles are a consciously aspirational and prescriptive project of law professors, *not* a descriptive codification of what *courts* hold the law to be. In particular, the definitional provision that AT&T quotes (section 1.19) is based on no legal authorities, but is "new" and was "promulgated" by the ALI itself for purposes of its own project. *See* § 1.19 Comment & n.a. AT&T knows this; it is for this reason that it puts the word "restatement" in quotes. *See* Opposition at 19.

In any event, not even the ALI aspires to treat options as equity interests. As explained by Professor Gilson (one of the reporters for the ALI Principles), the ALI's definition of equity interests that AT&T quotes includes *only* the underlying security that composes a convertible security. *See* ALI Principles §§ 1.19, 1.20. With respect to the option itself, the instrument at issue in this case, the ALI notably takes no position as to whether the option is an equity interest. *See id.* Indeed, this lack of a position is evident in the comments accompanying section 7.02 of the ALI Principles.

Section 7.02 concerns standing to bring derivative suits. It provides that holders of "an equity security" have such standing. *See* ALI Principles § 7.02(a). The comments explaining this provision, however, expressly state that "Section 7.02(a) takes no position on whether the holder of a warrant or right issued by the corporation and not attached to some other security should have standing to bring a derivative action." *See id.* § 7.02(a) Comment. If, as AT&T suggests, an option is an "equity security" (and thus an "equity interest") under the ALI Principles, then 7.02 could *not* fail to take a position on this issue; such holders would have standing by the terms of the rule. *See* Gilson Third Supp. Decl. ¶ 8. While the NewCo Class B shares clearly represent a 9.5 percent equity interest in Genuity, at issue here is whether the separate option is an *additional* equity interest. On this question, the ALI Principles explicitly disclaim that they are. *Id.*

But even if AT&T's reading of the ALI principles were correct, it would not be persuasive evidence of the meaning of "equity interest" here. Sections 3(1) and 271 are concerned with *current ownership interests*. *Nothing* in the definitional provisions or anywhere else in the ALI Principles, however, suggests that options, or other conversion right are *current* ownership interests. Moreover, the only general statement of corporate law that addresses this issue, the Model Business Corporations Act, provides that options cannot be characterized as current ownership. *See* Model Business Corporations Act § 7.40(2) (defining "shareholder" to include "a beneficial owner" of shares); *Id.* § 7.41 Official Comment (observing that "holders of options, warrants or conversion rights" are not shareholders under this definition).

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At the end of the day, AT&T's cited authorities do not support its categorical position. Nor is this surprising: not even AT&T consistently subscribes to the unrealistic position it has advocated in these proceedings. For example, in a brief to the D.C. Circuit defending Judge Greene's order requiring the Bell companies to disclose to the Justice Department any options they held in prohibited companies, AT&T argued that an option was not an "actual equity interest."[19] Similarly, within the last year, AT&T represented to the Commission that options are not ownership by omitting any reference to MediaOne's option to acquire an additional interest in Time Warner Entertainment ("TWE") in describing MediaOne's "ownership interest" in TWE in its official filings. Bell Atlantic/GTE March 14 Ex Parte at 4 n.2. And even AT&T's expert, Professor Coffee – in the course of filing another affidavit in support of AT&T – has used the phrase "equity interest" to refer to a present stock interest but not an option. Specifically, in an affidavit filed with Judge Greene in support of AT&T's request for a waiver in connection with its acquisition of McCaw Cellular, Professor Coffee described McCaw's subsidiary, LIN Cellular Communications Corp., as an entity "in which McCaw holds a 52% equity interest and an option to acquire the remaining equity." Affidavit of Professor John C. Coffee, Jr., at 9, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed May 24, 1994). *See also* AT&T's Motion for a Waiver of Section I(D), at 8, *United*

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[19] Brief of AT&T, *United States v. Western Elec. Co.*, No. 86-5641, at 14-15 (D.C. Cir. filed June 26, 1989). Specifically, AT&T defended Judge Greene's decision, which concluded that some options were prohibited by the consent decree's broader definition of "affiliated enterprise," as follows:

> For example, what if an RHC secretly paid a billion dollars for a long-term transferrable option to purchase 100% of a major manufacturer at a nominal price. * * * The RHC could then sell the option and profit from the manufacturing business, without ever seeking a waiver. * * * [T]he very conduct the Decree sought to end would occur for years, ***without an RHC ever owning an actual equity interest*** in the manufacturer . . . ."

Id. at 14-15 (emphasis added).

States v. Western Elec. Co., No. 82-0192 (D.D.C. filed June 7, 1994) (describing LIN as only "52%-owned" by McCaw, notwithstanding the option to acquire its remaining equity). In sum, neither AT&T nor its faithful expert appears to believe in the absolutist position that options are necessarily "equity interests" or "ownership."

2. NewCo Will Not Own The "Equivalent" Of A Forbidden Equity Interest In Genuity.

NewCo's conversion right will not amount to the "equivalent" of a prohibited "equity interest" in Genuity. The word "equivalent" in section 3(1) is not a word of uniform fixed meaning. Judge Stephen Williams, for example, in construing an MFJ-era consent decree that contained an almost identical definition of the term "affiliate," concluded that the meaning of the very same words "the equivalent thereof" in the phrase "equity interest (or the equivalent thereof)" was "not clear."[20] But whether under a strict interpretation of the term or a more flexible one, NewCo's option would not be the "equivalent" of an equity interest.

A strict interpretation readily excludes NewCo's option. Because "equity interests" are defined in terms of legal participation rights, the "equivalent" language of section 3(1) should similarly refer to those arrangements that confer the same (or very similar) participation rights as equity interests. For example, a device would be the "equivalent" of an equity interest if it conferred the three participation rights through contract rather than through a more traditional capital structure

[20] *United States v. Western Elec. Co.*, 12 F.3d 225, 239 (D.C. Cir. 1993) (Williams, J., dissenting) (point not disputed by majority).

investment. *See* Gilson Second Supp. Decl. ¶ 11. Equity "equivalents" would also include instruments that are not styled as common stock, or that may even lack voting rights, but that nevertheless carry the other traditional distribution and liquidation rights of equity ownership. *See* Gilson Decl. ¶ 18 ("[I]n appropriate circumstances partnership interests, debt interests that confer the right to participate in earnings rather than receive simple interest, and nonvoting preferred stock that also participates in earnings as well as receiving a fixed dividend, may serve as equity equivalents."). But NewCo's conversion right is not an equity "equivalent" under this straightforward construction for the same reason it is not an "equity interest": it confers *none* of the three traditional indicia of equity ownership.

If the Commission gives "equivalent" a more flexible meaning, AT&T's position still fails. The crux of AT&T's arguments is that the Class B option is the "equivalent" of an "equity interest" of 80 percent of Genuity because the Class B shares would be valued by the market at somewhere near 80 percent of the value of Genuity. This entire argument flows from AT&T's original reliance on Black's Law Dictionary to define "equivalent" as meaning "equal in value." *See* AT&T March 10 Ex Parte at 3 ("Two things are 'equivalent,' of course, if they are equal in value.") (citing Black's Law Dictionary (7th ed. 1999)). But while this is doubtless a linguistically permissible definition of "equivalent," it is by no means the only permissible one. Indeed, the complete definition upon which AT&T relies defines "equivalent" to mean "equal in value, force, amount, effect, or significance." NewCo's conversion right would not be the equivalent of an "equity interest" measured along several of these axes: the Class B shares lack the "force," "effect," and "significance" of stock because they lack rights to vote and participate in distributions. In fact, and consistent with the strict interpretation discussed above, the edition of AT&T's dictionary of choice that was current when the 1996 Act was written defined "equivalent" as "equal in value, force, measure, volume, power, *and* effect or having equal or corresponding import, meaning or significance." Black's Law Dictionary (6th ed. 1990). Under that definition, our Class B shares could never be the "equivalent" of an equity interest because they do not confer any participation rights, and therefore the "force," "power," and "effect," of traditional common stock.

Under a more flexible interpretation, "equivalent" is a term whose application necessarily depends on the policies relevant to the context in which it is applied. *Cf. American Broadcasting Co. v. FCC*, 663 F.2d 133, 138-39 (D.C. Cir. 1980) ("functional equivalency" standard for "like communications service" under section 202). The question is, "equivalent" for what purpose? Thus, notwithstanding AT&T's suggestion, it is entirely proper for the Commission to apply "equivalent" based on the purposes and policies of section 271. Indeed, it would be improper for the Commission, like AT&T, to place "sole reliance on a dictionary definition to find plain meaning [because that would] 'reflec[t] . . . no assessment of statutory objectives, no weighing of congressional policy, [and] no application of expertise in telecommunications.'" *In the Matter of AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd 21438, ¶ 27 n.108 (quoting *Alarm Monitoring Communications Comm. v. FCC*, 131 F.3d 1066, 1069 (D.C. Cir. 1997) (reversing Commission's interpretation of statutory term based entirely on a dictionary definition)).

Under this approach, the Class B conversion right is not an "equivalent," not only because it lacks the requisite participation rights, but also because it does not threaten, and indeed it even furthers, the statutory purpose of prohibiting the provision of in-region interLATA service without Commission approval. As we have described before, and as we reiterate below, our specific transaction affirmatively promotes the policies of 271 for several distinct reasons. Bell Atlantic/GTE

April 3, 2000 filing, at 13-16.[21] The direct effect of our proposal is to increase the net incentives of NewCo to complete the 271 process as soon as possible. Genuity is a unique asset, and the ultimate ability to reacquire ownership and control over it is the driving force behind NewCo's national data strategy. Furthermore, the risk to NewCo of losing Genuity forever by failing to achieve interLATA relief and of losing its initial investment in Genuity will also create a much bigger incentive for NewCo's continued progress in the 271 process. There is also no significant risk of discrimination to weigh against these benefits because, as a practical matter, discrimination by NewCo in favor of Genuity is highly implausible and would be readily detectable. *See* Declaration of Raymond F. Albers (filed Feb. 22, 2000) (attached to our Response). And while our interpretation prevents circumvention of 271's prohibition against the provision of in-region interLATA service without Commission approval, it simultaneously excludes instruments whose inclusion would serve no statutory purpose.

In contrast, AT&T's reliance on mere value equivalence would broaden the definition of "affiliate" so as to make "equity interest" meaningless. For example, under AT&T's definition of "equivalent," the Commission would be without discretion to conclude that the holder of a corporate bond valued at 10.1 percent of the company was not the owner of that company. Indeed, under AT&T's definition, $100 in cash is equivalent to a share of common stock that trades at $100. While such a definition of "equivalent" may be helpful in other theoretical contexts, it is useless here.

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[21] Although AT&T still asserts that the Commission cannot look to the policies of section 271 because the definition of "affiliate" appears in section 3(1), it has simply ignored our prior refutation of this point. *See* Bell Atlantic/GTE, April 3 Filing at 13 n.21.

AT&T also advances two additional reasons why, in its view, NewCo's right to obtain an equity interest in Genuity in the future should be deemed the "equivalent" of current equity ownership. As we discuss below, neither of these arguments has any merit.

Appreciation. The fact that NewCo can, after eliminating all applicable 271 restrictions and after the ultimate exercise of its full conversion rights, realize the appreciation in value of Genuity does not make those conversion rights the equivalent of current equity ownership. AT&T's argument to the contrary rests on an economic and legal fallacy that equates the right to share in appreciation of an asset with ownership of that asset. The right to appreciation can be obtained through a bet on a corporation with a derivative, such as an option, without any dealing with the corporation at all, let alone ownership. "The right to participate in the appreciation in the value of a corporation is not, by itself, an equity interest or its equivalent since securing the opportunity to share in this appreciation can be accomplished through derivative products that plainly are not equity interests under corporate law." Gilson Decl. ¶ 15. For example, GTE could sell Genuity today in exchange for cash, and purchase with that cash a proprietary derivative from Goldman Sachs whose value would appreciate by the same amount as that of Genuity. In that hypothetical, GTE would clearly not be an owner of or hold an equity interest in Genuity even though it would have secured the same right to share in its appreciation in value as if it owned Genuity all along. The point is that the fact that NewCo may share in the appreciation in Genuity's value does not render NewCo an owner or the equivalent thereof.

If the rule were otherwise, then any fixed-price option to purchase a company would necessarily constitute what AT&T calls "retroactive" ownership of that company after exercise of the option. Any fixed price option by its very nature allows its holder to capture the appreciation of the optioned asset upon exercise. In the typical case, the option holder pays a premium in advance for the right to purchase an asset within a specified time in the future at a pre-negotiated and fixed strike price. If the value of the optioned asset increases or remains above the strike price, the option holder will exercise the option, purchase the asset, and share in the appreciation to the extent of the difference between the strike price and the market price at the time of exercise. Thus, AT&T is really arguing that the Commission must regard all fixed-price options as *per se* ownership.

AT&T's argument, if accepted, would also prohibit any fixed-price merger of a BOC and another company owning an interLATA business even if the interLATA business were entirely divested before closing. In the case of an executory merger contract, so long as the price that the BOC pays for the other company is fixed in the merger contract, the BOC upon closing of the merger will capture all of the appreciation of the interLATA business that accrued between the signing of the contract and the divestiture. The Commission, however, has not succumbed to this fallacy. For example, as recently as March 2000, the Commission approved the U S WEST/Qwest merger conditioned on Qwest's divestiture of interLATA assets.[22] If the ability to share in the appreciation of an asset were the equivalent of ownership, then upon closing of the U S WEST/Qwest merger,

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[22] *See Qwest Communications Int'l, Inc. and US WEST, Inc., Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, Memorandum Op. and Order, CC Docket No. 99-272, 2000 WL 263685 (March 10, 2000).

U S WEST will illegally receive the same “right retroactively to obtain profits from *prior years*” that AT&T accuses us of securing. Opposition at 24.

In any event, even though appreciation is not, as AT&T says, a "fundamental aspect of equity," Opposition at 22, we have nonetheless modified our proposal so that NewCo will not share in any of Genuity's unique appreciation above NewCo's 10 percent equity interest in the event of a sale of NewCo's option. This voluntary undertaking forgoes all Genuity-specific appreciation in the event that NewCo does not obtain 271 approval, and it further enhances NewCo's incentives to comply with 271 because NewCo's ability to earn a rate of return on its initial investment above the S&P 500 will depend upon eliminating 95% of its applicable 271 restrictions.[23]

Risk and Cost. AT&T also suggests that NewCo's option must be the "equivalent" of an "equity interest" because, according to AT&T, it does not bear risk and is costless. This would be wrong even if its premises were accurate. The conversion right, until exercised, conveys no participatory rights that are characteristic of equity, and the restriction on exercise makes it anything but the equivalent of an equity interest.

But AT&T's premises were demonstrably false under our old proposal, and they are even more so in light of our recent modifications. Under our original proposal, we placed at risk a real opportunity by purchasing a conversion right rather then selling all of Genuity's assets in exchange

[23] As for AT&T's suggestion that this penalty is not genuine because Genuity may underperform the S&P 500, AT&T has once again changed course: After having argued for months that NewCo should not be permitted to share in the special appreciation associated with Genuity's interLATA business, it now argues that Genuity is a bad investment. This lacks credibility.

for cash and investing that cash in something else. Neither was our original proposal costless: in exchange for the conversion right, GTE was surrendering 90 percent of the value of Genuity.

Our April 28 modifications introduced even more risk and cost into the equation. We have now placed entirely at risk both our opportunity cost as well as 90 percent of the current value of Genuity. If NewCo does not secure 271 approval on more than 50 percent of Bell Atlantic's lines, NewCo's ability to acquire more than 10 percent will expire worthless. Nor can NewCo avoid this risk by selling the conversion right to a third party for value. Until the 50 percent threshold is reached, NewCo cannot sell an option to acquire more than 10 percent of Genuity's stock, and until the 95 percent threshold is reached, NewCo's proceeds from a sale of the option to acquire more than 10 percent of Genuity's stock are limited to the value of its initial investment (with its return capped by the S&P 500 Index). Thus, under our modified proposal, (i) NewCo has placed its entire option premium at risk, (ii) there is now a genuine possibility that neither NewCo nor anyone else will be able to exercise the option to acquire more than 10 percent of Genuity, and (iii) NewCo cannot even sell the option to a third-party until a significant contingency has occurred.

AT&T nevertheless insists that these modifications do not introduce any genuine risk because obtaining 271 approval turns "exclusively upon behavior in [NewCo's] control." Opposition at 11. This is nonsense. The exercise of any option turns on behavior in the control of the option holder: the holder decides whether to exercise. What matters is that NewCo cannot guarantee that it will secure the requisite 271 relief within the conversion period. The 271 approval process is not entirely within NewCo's control. It is disingenuous for AT&T to argue that we face *no* contingency in obtaining 271 approval for over 50 percent of Bell Atlantic's lines simply because we are highly motivated to do so. Indeed, it is perverse to argue that NewCo would *violate* 271 simply because it is likely to secure 271 compliance. Moreover, AT&T's argument ignores the practical reality of how difficult and enormously costly it is for a Bell company to make all the changes necessary to secure 271 approval. It also ignores the additional contingencies introduced into the 271 process by changing technology, such as the introduction of new interconnection and unbundling requirements that are specifically tailored to DSL providers. Under our proposal, NewCo will place at real risk the lion's share of GTE's entire initial investment in Genuity.[24]

[24] AT&T belittles the fact that reaching the 50 percent threshold would "merely" require achieving 271 approvals in two more of the large Bell Atlantic states. Opposition at 12 n.11. It is by no means a legal certainty that NewCo will achieve those necessary approvals within five years, considering that only one Bell company has achieved only one 271 approval in more than four years since enactment of the Telecommunications Act of 1996.

Nor is our option to obtain an interest in Genuity in the future costless. NewCo is paying for the option in-kind with 90 percent of Genuity – assets that are now highly valuable and owned by GTE. No cited authority supports AT&T's implicit argument that an option or other conversion right is a "sham" if it is pre-paid. Indeed, in any convertible security, the exercise price is pre-paid, yet such convertible securities are routinely treated as *not* current equity ownership, as demonstrated above. Moreover, one of the important MFJ precedents involved an option that could be exercised at a "nominal price." See Bell Atlantic/GTE Supplemental Filing, at 43 (discussing SBC case). As a legal and economic matter, it should make little difference whether we pay for our conversion rights in advance or upon exercise. The price today of an option or other conversion right to obtain 70 percent of Genuity will simply reflect 70 percent of the expected net present value of Genuity. That is precisely what we are paying for the option, although under our proposal we are paying in kind and up front by surrendering 90 percent of GTE's current ownership in Genuity. The Commission should, in fact, *favor* pre-payment because it *increases* NewCo's incentives to comply with 271 by making it more costly for NewCo to walk away from the 271 process than it would be if NewCo deferred payment for the additional 70 percent of Genuity until exercise.

B. NewCo Will Not Control Genuity Before It May Lawfully Do So.

Reflecting yet another major course reversal, AT&T's May 5 Opposition focuses primarily on ownership and places much less emphasis on the question of control than did AT&T's earlier submissions. That is not surprising. We had largely eliminated any control issue with our April 3 filing, and the modifications to the board selection process and investor safeguards that we outlined in our April 28 submission (and clarify in Appendix D today) only further confirm that NewCo will have no improper control over Genuity's business pending 271 relief.

As we have previously pointed out (and AT&T has conceded), control is a fact-specific and context-specific inquiry. *See* Bell Atlantic/GTE April 3 Filing at 16 (citing AT&T filings). The Commission has extensive experience evaluating questions of control in many different commercial contexts and under various statutory and regulatory regimes. Typically, the Commission applies its "totality of the circumstances" approach to control, *see* Coffee Decl. ¶ 9, in light of the underlying purposes of the particular regulatory regime at issue. In other words, to determine whether one entity exercises cognizable or impermissible "control" over another, the Commission ordinarily examines the purposes for which the control test is being applied.

Here, the purpose of the control inquiry in the context of sections 3(1) and 271 is to ensure that a Bell company is not *providing* prohibited in-region interLATA services through another company by virtue of its control over that company. Thus, the concept of control that is significant for purposes of the 271 restriction is such control as will enable the BOC to benefit from the combined provision of both local and long distance services within its region. *See AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd 21438, ¶¶ 5, 36-37 (1998).

NewCo will have no such prohibited control over Genuity's provision of interLATA services. First, the public shareholders, not NewCo, will have 90 percent voting control over Genuity and its management. Second, Genuity will be run by an independent board – including 11 of 13 members who are outside directors with no prior relationship with GTE or Bell Atlantic. Our modified April 28 proposal now ensures that *within 90 days following the IPO*, a majority of Genuity's board will have been selected after the IPO (not installed at the outset by GTE or Bell Atlantic), and within nine months, all members of the board other than the lone Class B director will have been elected by the public shareholders. Third, Genuity's board and its officers will owe fiduciary duties to the public shareholders. Fourth, the incentive compensation for Genuity's managers will be keyed to the performance of Genuity, not NewCo. And fifth, NewCo's commercial relations with Genuity will all be contractually specified.[25]

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[25] Covad claims that the transitional services contracts between NewCo and Genuity will have NewCo "performing nearly every single task necessary for the operation of Genuity," and that these contracts are "extendable indefinitely by the parties." Comments of Covad Communications Company at 12 (May 5, 2000). Covad is misinformed. These contracts only encompass those services that are necessary to allow Genuity to achieve viability and independence through a reasonable transition away from GTE's centralized systems. They are all for terms of no more than one year and may be terminated at any time by Genuity without penalty. *See* Declaration of Paul R. Gudonis ¶ 3 ("These contracts include a number of features that ensure Genuity's complete independence from NewCo; indeed, these temporary contracts are essential to Genuity's ability to

operate as a viable independent business during its transition away from reliance on GTE[.]"). Further, contrary to Covad's assertion, under our modified proposal of April 28, as clarified by the Revised Exhibit A attached hereto as Appendix D, these contracts may only be renewed by the parties if NewCo gives the Commission 60 days notice of the intent to renew, and the Chief of the Common Carrier Bureau does not first object to the renewal. Thus, as Genuity's CEO concludes, the "cumulative effect of these factors, along with the fiduciary duty Genuity's Board owes to its public shareholders, ensures that Genuity will switch providers of these contractually specified services if doing so would give Genuity a better deal." *Id.*

Moreover, although the investor safeguards we originally proposed were well supported by Commission precedents holding that such protections (taken together) do not constitute control, our modified proposal pares these safeguards back even further. It is now manifestly clear that over the course of the next five years, Genuity will be able to carry out its entire business plan (as described in its registration statement) without once seeking the consent of NewCo under these investor safeguards. *See* Declaration of Paul R. Gudonis ¶ 2 ("These investor safeguards will not impede in any way the implementation of Genuity's five-year business plan. Neither a vote of NewCo's Class B shares nor NewCo's consent will be required to implement Genuity's five-year business plan in full."). In addition, we have now significantly increased the percentage vote that may be held by a single Class A shareholder to 20 percent (more than twice the vote held by NewCo). Finally, we have stipulated in our modified proposal that if NewCo were to enter into commercial loan agreements with Genuity, it could provide no more than 25 percent of the aggregate debt financing that Genuity may incur in the period before NewCo exercises its conversion rights.

AT&T's principal argument on control is that the simple existence of these conversion rights will cause Genuity's officers to act at the behest of NewCo. But NewCo's thoroughly independent board, which will owe its fiduciary duties to the public shareholders, nullifies any such hypothetical concern. Furthermore, our new option structure, which requires NewCo to satisfy the 50 percent 271 threshold before it has any right at all to convert into a greater than 10 percent interest, also significantly weakens AT&T's argument, since there is now a genuine possibility that NewCo will never be in a position to exercise its option to take control of Genuity. This possibility renders even more tenuous the notion that NewCo could somehow exercise indirect control over Genuity's management by virtue of the expectation that NewCo will ultimately own the company.

For all these reasons, NewCo will clearly not exercise impermissible control over Genuity pending 271 relief.

C. Our Proposal Is Consistent With, and Indeed Advances, the Purposes of Section 271.

Finally, our proposal, especially as modified, is not only fully consistent with the purposes of section 271, but it positively furthers those purposes. It will create a powerful new net incentive for NewCo to complete the 271 process as rapidly as possible in all of its in-region states in order to exercise its conversion rights and take ownership of Genuity. *See In re Qwest Communications Int'l, Inc. and U S WEST, Inc.*, CC Docket No. 99-272, ¶ 2 (rel. Mar. 10, 2000) (recognizing that Qwest/U S WEST will have "powerful new incentives" to comply with section 271 to realize the maximum integrated value of Qwest's national network). Moreover, the very substantial risk to NewCo of losing Genuity forever if it fails to achieve 271 relief will also create a much bigger "stick" to spur 271 compliance.

Our April 28 modification dramatically enlarges this downside risk: If NewCo fails to satisfy the 50 percent 271 threshold within the conversion period, it will totally lose any ability to get back the value of GTE's original investment in Genuity – a several billion dollar loss. And beyond the 50 percent threshold, the only way NewCo can realize the full and unique value of that investment over and above the standardized S&P 500 cap is to push forward as quickly as possible and attain at least 95 percent 271 relief. These requirements create even more powerful mechanisms than section 271 alone provides to compel compliance with the market opening provisions of the Communications Act.

Taken as a whole, then, the Bell Atlantic/GTE merger, as conditioned by our proposed solution for the Genuity interLATA issues, will strongly serve the public interest and the specific goals of section 271.

CONCLUSION

The Commission should promptly grant the requested license transfer applications.

Respectfully submitted,

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